NO 18641

IN THE UNITED STATES COURT OF APPEALS

FOR THE NINTH CIRCUIT

FOREST G. SMITH, JR. and
ROSE MARY SMITH,

Appellants,

vs.

COMMISSIONER OF INTERNAL
REVENUE,

Appellee

BRIEF FOR THE APPELLANTS

ON PETITION
FOR REVIEW OF DECISION OF
THE TAX COURT OF THE UNITED STATES

ERNEST R. MORTENSON
EUGENE HARPOLE

961 East Green Street
Pasadena, California

Attorneys for Appellants

NO. 18641

IN THE UNITED STATES COURT OF APPEALS

FOR THE NINTH CIRCUIT

FOREST G. SMITH, JR. and
ROSE MARY SMITH,

Appellants,

vs.

COMMISSIONER OF INTERNAL
REVENUE,

Appellee.

BRIEF FOR THE APPELLANTS

ON PETITION
FOR REVIEW OF DECISION OF
THE TAX COURT OF THE UNITED STATES

ERNEST R. MORTENSON
EUGENE HARPOLE

961 East Green Street
Pasadena, California

Attorneys for Appellants

TOPICAL INDEX

TABLE OF AUTHORITIES

Statutes

Regulations

NO. 18641

IN THE UNITED STATES COURT OF APPEALS

FOR THE NINTH CIRCUIT

FOREST G. SMITH, JR. and
ROSE MARY SMITH,

Appellants,

vs.

COMMISSIONER OF INTERNAL
REVENUE,

Appellee.

BRIEF FOR THE APPELLANTS

OPINION BELOW

The opinion of the Tax Court was filed on May 28, 1962, and its decision, based upon said opinion, and whose review is sought in this appeal, was entered December 13, 1962 (R. 418-434, 436).

JURISDICTION

The Tax Court had jurisdiction of this matter under Section 7442 of the Internal Revenue Code of 1954 (26 USCA 7442) and Section 6213 of the Internal Revenue Code of 1954 (26 USCA 6213). This Court has jurisdiction under Section 7482 of the Internal

Revenue Code of 1954 (26 USCA 7482).

This petition for review involves deficiencies in the petitioners' Federal income taxes for the calendar years 1954, 1955 and 1956 (R. 437-439). On April 29, 1960, the Commissioner of Internal Revenue mailed to the taxpayers, by registered mail, a notice of deficiency covering said years (R. 12-20).

The taxpayers filed a petition for redetermination with the Tax Court on July 15, 1960 (R. 5-20). On September 7, 1960, the Commissioner filed an answer to the taxpayers' petition (R. 21). On April 10, 1961, pursuant to leave granted by the Tax Court taxpayers filed an amendment to their petition therein alleging that no sale of Clock Restaurants took place in 1956 and that the Commissioner of Internal Revenue had erred in failing to allow a loss carry-back to the year 1954 of $101,888.73 resulting from the sale of Clock Country Club in the calendar year 1956 (R. 23-27). On April 13, 1961, the respondent filed an amended answer in the proceeding before the Tax Court wherein an additional deficiency of $5,735.29 was asked for the calendar year 1956 (R. 29-30).

On March 28, 1962, the Tax Court filed its opinion (R. 418-434). The Tax Court's decision whose review is sought in this proceeding was entered December 13, 1962 (R. 436). The case is brought to this Court by a Petition for Review filed with the Tax Court on March 11, 1963 (R. 437-439). At the same time the petitioners filed the following statement of points upon which they intend to rely in this review:

1. The Tax Court erred in finding as a fact that as a

part of the consideration for Smith's sale of Clock Restaurants to Peterson, the latter assumed $603,687.96 of Smith's liabilities which pertained to said restaurants when the evidence before the Tax Court was that instead of assuming the liabilities of Smith, Peterson merely took the assets of Clock Restaurants subject to said liabilities.

2. The Tax Court erred in finding as a fact that the sale by Forest G. Smith, Jr., of the Clock Restaurants to Robert O. Peterson was a closed and completed transaction in the calendar year 1956 for the reason that the evidence before the Tax Court did not support such a finding of fact but required a finding of fact that the sale was not completed until subsequent to January 1, 1957.

3. The Tax Court erred in concluding as a matter of law that no agency existed between the seller and purchaser of Clock Restaurants for the reason that said conclusion is supported neither by the evidence before the Tax Court nor the facts as found by the Tax Court.

4. The Tax Court erred in concluding that as a matter of law sale of Clock Restaurants was completed on October 30, 1956, for the reason that said conclusion of law is not supported by the evidence before the Tax Court.

5. The Tax Court erred in construing the written memorandum between Forest G. Smith, Jr. and Robert O. Peterson of October 30, 1956, concerning the sale of Clock Restaurants, as providing that Robert O. Peterson thereby assumed and agreed to pay the debts of Forest G. Smith, Jr., whereas said agreement,

by its terms, only provides that Robert O. Peterson may take the assets of Clock Restaurants subject to the debts of Forest G. Smith.

6. The Tax Court erred in concluding, as a matter of law, that the transfer of petitioner's property subject to his debts was in substance the receipt of "money" in the amount of such debts within the meaning of §1001(b) of the Internal Revenue Code of 1954.

7. The Tax Court erred in failing and refusing to make a finding or conclusion as to whether or not the rights of Forest G. Smith, Jr., under the memorandum agreement between himself and Robert O. Peterson of October 30, 1956, did or did not have a fair market value.

8. The Tax Court erred in deciding that there were deficiencies of $53,359.65, $5,952.10 and $17,214.61 respectively in petitioner's Federal income taxes for the taxable years 1954, 1955 and 1956.

9. The Tax Court erred in failing to decide that there were overpayments of $15,000.00, $4,673.34 and $1,645.43 respectively of petitioner's Federal income taxes for the taxable years 1954, 1955 and 1956 (R. 440-442).

STATUTES AND REGULATIONS INVOLVED

Sixteenth Amendment to the Constitution of the United States:

"INCOME TAX

"The Congress shall have power to lay and collect taxes or incomes, from whatever source derived, without

apportionment among the several States, and without regard to any census or enumeration."

Section 1001(b) Internal Revenue Code of 1954:

"(b) AMOUNT REALIZED

"The amount realized from the sale or other disposition of property shall be the sum of any money received plus the fair market value of the property (other than money) received."

Treasury Regulation 1.1001-1(a):

"1(a) COMPUTATION OF GAIN OR LOSS

"The amount realized from a sale or other disposition of property is the sum of any money received plus the fair market value of any property (other than money) received. The fair market value of property is a question of fact, but only in rare and extraordinary cases will property be considered to have no fair market value."

Section 172(a)(b)(1)(A) Internal Revenue Code of 1954:

"NET OPERATING LOSS DEDUCTION

"(a) Deduction Allowed - There shall be allowed as a deduction for the taxable year an amount equal to the aggregate of (1) the net operating loss carryovers to such year, plus (2) the net operating loss carrybacks to such year. For purposes of this subtitle, the term 'net operating loss deduction' means the deduction allowed by this subsection.

"(b) Net operating loss carrybacks and carryovers. --

"(1) Years to which loss may be carried - A net operating loss for any taxable year ending after December 31, 1953, shall be --

"(A) A net operating loss carryback to each of the 2 taxable years preceding the taxable year of such loss."

Section 172(c) Internal Revenue Code of 1954:

"NET OPERATING LOSS DEFINED

"For purposes of this section, the term 'net operating loss' means (for any taxable year ending after December 31, 1953) the excess of the deductions allowed by this chapter over the gross income. Such excess shall be computed with the modifications specified in subsection (d)."

Section 172(d)(4)(A) Internal Revenue Code of 1954:

"(d) MODIFICATIONS

"The modifications referred to in this section are as follows:

"(4) Nonbusiness deductions of taxpayers other than corporation - In the case of a taxpayer other than a corporation, the deductions allowable by this chapter which are not attributable to a taxpayer's trade or business shall be allowed only to the extent of the amount of gross income not derived from such trade or business. For purposes of the preceding sentence --

"(A) any gain or loss from the sale or other disposition of --

"(i) property, used in the trade or business, of a character which is subject to the allowance for depreciation provided in section 167, or

"(ii) real property used in the trade or business, shall be treated as attributable to the trade or business; . . . . "

Treasury Regulations 1.172-3(a)(3)(ii):

"3(a) NET OPERATING LOSS IN CASE OF A TAXPAYER OTHER THAN A CORPORATION

"Modification of deductions - A net operating loss is sustained by a taxpayer other than a corporation in any taxable year beginning after December 31, 1953, if and to the extent that, for such year, there is an excess of deductions allowed by chapter 1 of the 1954 Code over gross income computed thereunder; this rule shall apply even though the loss year is otherwise subject to the 1939 Code. In determining the excess of deductions over gross income for such purpose --

"(3)(ii) SALE OF BUSINESS PROPERTY

"Any gain or loss on the sale or other disposition of property which is used in the taxpayer's trade or business and which is of a character that is subject to the allowance for depreciation provided in section 167, or of real property used in the taxpayer's trade or business, shall be considered, for purposes of section 172(d)(4), as attributable to, or derived from,

the taxpayer's trade or business. Such gains and losses are to be taken into account fully in computing a new operating loss without regard to the limitation on nonbusiness deductions. Thus, a farmer who sells at a loss land used in the business of farming may, in computing a net operating loss, include in full the deduction otherwise allowable with respect to such loss, without regard to the amount of his non-business income and without regard to whether he is engaged in the trade or business of selling farms. Similarly, an individual who sells at a loss machinery which is used in his trade or business and which is of a character that is subject to the allowance for depreciation may, in computing the net operating loss, include in full the deduction otherwise allowable with respect to such loss."

Section 1231(a)(1) and (b)(1)(A), (B), Internal Revenue Code of 1954:

"(a) PROPERTY USED IN THE TRADE OR BUSINESS AND INVOLUNTARY CONVERSIONS

"General Rule - If, during the taxable year, the recognized gains on sales or exchanges of property used in the trade or business, plus the recognized gains from the compulsory or involuntary conversion (as a result of destruction in whole or in part, theft or seizure, or an exercise of the power of requisition or condemnation or the threat or imminence thereof)

of property used in the trade or business and capital assets held for more than 6 months into other property or money, exceed the recognized losses from such sales, exchanges, and conversions, such gains and losses shall be considered as gains and losses from sales or exchanges of capital assets held for more than 6 months. If such gains do not exceed such losses, such gains and losses shall not be considered as gains and losses from sales or exchanges of capital assets. For purposes of this subsection --

"(1) In determining under this subsection whether gains exceed losses, the gains described therein shall be included only if and to the extent taken into account in computing gross income and the losses described therein shall be included only if and to the extent taken into account in computing taxable income, except that section 1211 shall not apply;

"(b) Definition of property used in the trade or business -- For purposes of this section --

"(1) General rule - The term 'property used in the trade or business' means property used in the trade or business, of a character which is subject to the allowance for depreciation provided in section 167, held for more than 6 months, and real property used in the trade or business, held for more than 6 months, which is not --

"(A) property of a kind which would properly be includible in the inventory of the taxpayer if on hand at the close of the taxable year,

"(B) property held by the taxpayer primarily for sale to customers in the ordinary course of his trade or business, or . . . . "

Section 1698 California Civil Code:

"(Written contracts, how modified) A contract in writing may be altered by a contract in writing, or by an executed oral agreement, and not otherwise. (Enacted 1872; Am. Code Amdts. 1873-74, p. 243)."

Section 1639 California Civil Code:

"Interpretation of written contracts. When a contract is reduced to writing, the intention of the parties is to be ascertained from the writing alone, if possible; subject, however, to the other provisions of this title. (Enacted 1872)."

Section 1638 California Civil Code:

"The language of a contract is to govern its interpretation, if the language is clear and explicit and does not involve an absurdity."

Section 1856 California Code of Civil Procedure.

"§1856. An agreement reduced to writing deemed the whole: (When evidence of other terms admitted; Certain evidence not excluded; Application to deeds and wills). When the terms of an agreement have been reduced to

writing by the parties, it is to be considered as containing all those terms, and therefore there can be between the parties and their representatives, or successors in interest, no evidence of the terms of the agreement other than the contents of the writing, except in the following cases·

"1. Where a mistake or imperfection of the writing is put in issue by the pleadings;

"2. Where the validity of the agreement is the fact in dispute.

"But this section does not exclude other evidence of the circumstances under which the agreement was made or to which it relates, as defined in Section 1860, or to explain an extrinsic ambiguity, or to establish illegality or fraud. The term agreement includes deeds and wills, as well as contracts between parties."

QUESTIONS PRESENTED

I

Was the sale of Clock Restaurants made to Robert O. Peterson by the petitioner, Forest G. Smith, Jr. during the calendar year 1956?

II

Did Robert O. Peterson agree to assume the liabilities of

Forest G. Smith, Jr. or merely agree to purchase the assets of Clock Restaurants "subject to" Smith's debts?

III

Did the agreement of Robert O. Peterson to take the assets of Clock Restaurants "subject to" the liabilities of Forest G. Smith, Jr. in the amount of $603,687.96 amount to the receipt of money in that sum by Smith during the calendar year 1956 under the provisions of §1001(b) of the Internal Revenue Code of 1954?

IV

Did the Tax Court err in deciding that there were deficiencies of $53,359.65, $5,952.10 and $17,214.61 in the petitioner's Federal income taxes for the calendar years 1954, 1955 and 1956, respectively, instead of overpayments for said years in the amounts of $15,000.00, $4,673.34 and $1,645.43?

STATEMENT

Taxpayers filed income tax returns for the calendar years 1954, 1955 and 1956 with the District Director of Internal Revenue at Los Angeles, California, in which payments of tax for said years were reported in the respective amounts of $15,000.00, $4,673.34 and $1,645.43 (R. 46, 64, 84; Joint Exhibits 1-A, 2-C and 3-B).

The Commissioner of Internal Revenue determined deficiencies in the petitioners' Federal income taxes for the calendar years 1954, 1955 and 1956 in the respective amounts of $66,551.05, $7,835.30 and $11,479.32 (R. 12). By an amended

answer filed in the Tax Court proceeding the Commissioner asked to increase the deficiency determined for 1956 to $17,214 61 (R. 29-31). The taxpayers petitioned the Tax Court for a redetermination of the deficiencies asserted (R. 5-20). On April 10, 1961, the petitioners, by leave of the Tax Court, filed an amendment to their petition wherein they alleged that the Commissioner erroneously failed to allow a loss carryback of at least $187,850.14 from the calendar year 1956 to the years 1954 and 1955 (R. 25-27). Certain adjustments in petitioners' reported income were stipulated and are not now in controversy (R. 34-37, Pars. 4, 5, 6 Stip. Facts). The Tax Court decided there were deficiencies of $53,359.65, $5,952.10 and $17,214.61, respectively, for the years 1954, 1955 and 1956 (R. 436). The taxpayers have petitioned for a review of the Tax Court's decision by the United States Court of Appeals for the Ninth Circuit (R. 437-439).

On October 30, 1956, Forest G. Smith, Jr. and Robert O. Peterson, hereinafter referred to as Smith and Peterson, entered into a written "Memorandum Agreement", a copy of which is fully set forth in a stipulation of facts and as a finding of fact, on pages 3 to 6, inclusive, of the Tax Court's opinion (R. 420-423). On or about November 1, 1956, Peterson took possession of the assets of Clock Restaurants which were the subject of the Agreement of October 30, 1956 (R. 37).

Smith's cost basis of the assets of Clock Restaurants sold to Peterson was stipulated by the parties and found by the Tax Court to be $290,134.40 (R. 42, Par. 20, Stip. Facts; 424). None of the

assets were subject to a mortgage (Ex. 6-F-1, 2; R. 141). The Tax Court found the assets to be of the fair market value of $603,687.96 on October 31, 1956 (R. 424). The parties stipulated and the Tax Court found it to be a fact that on October 31, 1956, Smith had liabilities of $603,687.96 which pertained to the Clock Restaurants (R. 43). None of the liabilities were secured by a mortgage (R. 141).

Article (4) of the Memorandum Agreement of October 30, 1956, between Smith and Peterson was found to be a fact by the Tax Court and it provided: "Peterson hereby agrees to accept all of the above and foregoing assets referred to in paragraphs (1), (2) and (3) and to pay therefor by taking them subject to the liabilities as shown and disclosed on said financial statement dated September 30, 1956, * * * " (emphasis supplied; R. 421, Ex. 6-F). The Tax Court found it to be a fact that "as a part of the consideration for Smith's sale of the restaurants to Peterson, Peterson assumed these liabilities" (R. 424). The petitioners contend the record contains no competent evidence to support such a finding of fact (R. 439, 441). The Tax Court's ultimate conclusion of law was "viewing the transfer of petitioners' property subject to his debts as the substantial receipt of 'money' in the amount of such debts within the meaning of section 1001(b) of the 1954 Code, we do not find it necessary to decide whether or not the sale contract itself possessed a fair market value " (emphasis supplied; R. 434). It was the testimony of Harold B. Lloyd, an experienced appraiser, that in his opinion the rights of Forest G. Smith, Jr., under the

Memorandum Agreement of October 30, 1956, had no fair market value at any time during 1956 for the reason that no market could be found for such rights. No prudent, well adjusted person would pay anything for them (R. 16, 19, 27).

Article (6) of the Memorandum Agreement of October 30, 1956, provided:

> "Peterson has analyzed the liabilities of Clock Restaurants as shown by said financial statement of September 30, 1956, and understands that there are presently outstanding approximately $30,000.00 of checks issued by Clock Restaurants to its creditors and that no funds are in the bank account of Clock Restaurants from which said checks can be paid and that sufficient funds must be deposited in the bank account of Clock Restaurants to cover said checks forthwith. Peterson further understands that approximately $116,000.00 of taxes will become delinquent on the 31st day of October, 1956, which taxes represent payments due the United States Government for withholding and excise taxes, and to the State of California for unemployment and sales taxes. The parties hereto mutually understand and agree that there would not be sufficient time to consummate this transaction through a bulk sales escrow in time to pay the above referred to immediately pressing obligations, and that, accordingly, in the event that Peterson advances funds in the sum of $146,000.00 with which to pay said pressing obligations,

that Peterson will concurrently therewith be delivered the immediate possession of all of the Clock Restaurants and the assets which are the subject matter of this agreement, and that thereafter upon the written demand by Peterson a bulk sales escrow will be opened for the consummation of the transactions contemplated by this agreement, and that if the creditors of Clock Restaurants prevent the consummation of said escrow by requiring immediate payment of their respective claims, Peterson will have the right and privilege of delivering possession to Smith or to any person entitled thereto of such of the assets being transferred by Smith to Peterson under this agreement which are subject to attack by said creditors and shall be relieved of any obligations or liabilities for the payment of said creditors' claims. As to any funds advanced by Peterson for the payment of any of the creditors of Clock Restaurants, Smith agrees to reimburse Peterson upon demand for repayment of said advances.

"As to any assets hereby transferred by Smith to Peterson which are not subject to attack by Smith's creditors, Peterson shall be entitled to keep and retain the same without the payment to Smith or to the creditors of Smith or of Clock Restaurants of any sum or other consideration therefor." (R. 421, 422).

Article (9) of the Memorandum Agreement, provided:

"In the event that the bulk sales escrow hereinabove referred to is consummated and closed, Peterson agrees to indemnify Smith and hold Smith harmless from any loss or liability by reason of or arising out of the conducting of the business of Clock Restaurants by Peterson incurred subsequent to the date of the delivery of possession of said restaurants to Peterson. Until the closing of said bulk sales escrow, Peterson will operate as agent for Smith in the conducting of the business of said Clock Restaurants by Peterson, but Peterson does hereby agree to indemnify and hold Smith harmless from any loss or liability for any debts, obligations or liabilities incurred by Peterson in the operation of said restaurant business from and after the date that Peterson takes possession." (R. 423).

It has been stipulated by the parties and found as a fact by the Tax Court that Peterson took possession of the assets of Clock Restaurants on or about November 1, 1956 (423, 37).

B. D. S. Company, a limited copartnership, was formed on the 1st day of April, 1953. Joseph W. Drown, James E. Bahan, Joseph R. Bahan, Forest G. Smith, Jr. and Winifred M. Schneider were general partners, and Mary Eileen Bahan, Lillian Agnes Bahan, Spearl Ellison, R. C. A. Lubach, Jack M. Drown and Maxine M. Code, limited partners (R. 38, 39, 142-150; Ex. 7-G, Stip. Facts). In November, 1956, Smith assigned his partnership interest in B. D. S. Company to Peterson (R. 40, 246; Ex. 11-K,

Stip. Facts). On November 5, 1956, Peterson became a general partner in B. D. S. Company and Forest G. Smith was eliminated as a general partner (R. 40, 251, 252; Ex. 14-N, Stip. Facts).

On or about November 30, 1956, Robert O. Peterson wrote letters to the various creditors of Clock Restaurants in each of which letters the following statement was made (R. 285-308; Exs. 20-T - 1 to 23, Stip. Facts):

> "As I have previously indicated to you, I intend to purchase certain of the Clock Restaurants from Forest G. Smith, Jr. and to assume certain of his liabilities. An escrow to complete the sale will be opened in the near future and notice of sale will be recorded and published.
>
> "Unless I notify you to the contrary, pending completion of the sale, the Clock Restaurants will be under my control and management and the following program will be follows.
>
> "It is my understanding that so long as the above program is followed, you will not demand payment of the amounts now owing to you by Forest G. Smith, Jr. on account of the Clock Restaurants."

A notice of an intended sale on February 25, 1957, of Clock Restaurants to Peterson by Smith was filed in the Office of the County Recorder in Los Angeles and Orange Counties, California, and published in a legal newspaper during that month (R. 412, 413).

On or about February 27, 1957, B. D. S. Company mailed letters to creditors of Clock Restaurants wherein the following statement was made to each of those creditors: "The B. D. S. Company, a limited partnership, now doing business as Clock Restaurants, of which the undersigned Robert O. Peterson is a general partner, has completed purchase of Clock Restaurants from Forest G. Smith, Jr. In accordance with said letter to you of November 30, 1956, above referred to, the undersigned does hereby assume the liabilities of Forest G. Smith, Jr., mentioned in said letter, and does hereby guarantee payment of the unpaid balance thereof in consideration of your agreement not to demand payment so long as payments on account of said balance are made in the manner and at the rate set forth in said letter." (R. 309-349; Exs. 20-T - 24 to 43, Stip. Facts). Said twenty letters each stated that Robert O. Peterson, as of that date, assumed the liability of Forest G. Smith, Jr. to the addressee (R. 309-349).

It was stipulated by the parties and found to be a fact by the Tax Court that $326,443.09 of the liabilities of Smith were paid by Peterson during 1956 and $220,271.34 of the liabilities were paid during 1957 by either Peterson or B. D. S. Company (R. 43, 425).

The petitioners reported no capital gain from sale of Clock Restaurants on their 1956 income tax return but elected to treat the transaction as a deferred payment sale (R. 112). The Commissioner of Internal Revenue determined that sale of the Clock Restaurants by petitioners was a closed transaction in 1956 and that a capital gain of $313,553.56 was thereby realized in 1956

(R. 18). The Tax Court sustained the Commissioner's determination as to said item (R. 428).

Petitioners reported the receipt of a capital gain of $220,271.34 from the sale of Clock Restaurants to Robert O Peterson on their Federal income tax return filed for the calendar year 1957 (R. 136). No dispute exists as to the amount of gain ultimately to be realized by the taxpayers from the sale of Clock Restaurants. The question is, in what year did they realize the gain?

SUMMARY OF ARGUMENT

Forest G. Smith's sale of Clock Restaurants to Robert O. Peterson is shown by the documentary evidence in the record to have been made in 1957 and not in 1956. The agreement of Peterson to take the assets of Clock Restaurants subject to the debts of Forest G. Smith, Jr. created no obligation on Peterson's part to pay those debts. Smith realized a gain from the sale of Clock Restaurants only at such times as Peterson had paid Smith's debts in an amount that exceeded $290,134.10, the cost of Clock Restaurants to Smith. Until such time as his debts were actually paid by Peterson, Smith had received neither money nor other property of any fair market value from the sale of Clock Restaurants within the meaning and intent of §1001(b) of the Internal Revenue Code of 1954.

ARGUMENT

I

BY THE TERMS OF THE MEMORANDUM AGREEMENT BETWEEN FOREST G. SMITH, JR. AND ROBERT O. PETERSON OF OCTOBER 30, 1956, PETERSON WAS IN POSSESSION OF CLOCK RESTAURANTS AS AN AGENT OF SMITH AND NOT AS THEIR OWNER DURING THE REMAINDER OF THE YEAR 1956.

The Tax Court fully set forth the written agreement of October 30, 1954, in its findings of facts (R. 420-423). Paragraph (9) of that agreement provided: " * * * Until the closing of said bulk sales escrow, Peterson will operate as agent for Smith in the conducting of the business of said Clock Restaurants by Peterson, but Peterson does hereby agree to indemnify and hold Smith harmless from any loss or liability for any debts, obligations or liabilities incurred by Peterson in the operation of said restaurant business from and after the date that Peterson takes possession". The terms of the written agreement are clear (R. 423, 389). Nevertheless, the Tax Court, after first finding as a fact that a bulk sales escrow was never opened because Peterson and his attorney decided it was unnecessary, concluded that as a matter of law no agency relationship existed between the seller and purchaser (R. 430). It then held the sale to have been completed on October 30, 1956 (R. 428). It is true the Tax Court found, that in their 1956 income tax return, the petitioners treated the sale of Clock Restaurants to Peterson as taking place as of October 30, 1956

(R. 424). The petitioners' statement in their income tax return is here contended to have been erroneous. It is in conflict with at least forty statements to the contrary made by Peterson concerning his intent as to the sale as well as with the terms of Section (9) of the Memorandum Agreement of October 30, 1956. The conflict between these statements illustrates the wisdom of the California legislature when it provided in §1698 of the California Civil Code: "A contract in writing may be altered by a contract in writing, or by an executed oral agreement, and not otherwise." It is submitted that the Tax Court's decision and the petitioners' 1956 income tax return have both come to the same erroneous legal conclusion as to the legal effect of the Memorandum Agreement of October 30, 1956.

The clear terms of Section (9) of the sales agreement provided that Peterson was to operate the restaurants as the Agent of Smith, and parol evidence was not admissible to explain the intention of the parties. Alexander v. Commissioner, 13 B.T.A. 1169. A written stipulation of facts was entered into by the taxpayers and the Commissioner. Among the stipulated facts was the following: "Forest G. Smith, Jr., one of the petitioners herein, and Robert O. Peterson, entered into an agreement bearing date October 30, 1956, a correct copy of which agreement is attached hereto and marked Joint Exhibit 6-F" (R. 37). The preamble of that stipulation provided that either party might produce other and further evidence, not inconsistent with the facts herein stipulated. The Tax Court's Rule 31 (b)(5) provides in its material part: "The Court * * * will not receive evidence tending to qualify, change, or contradict any

fact properly introduced into the record by stipulation." The Supreme Court of California has said in the case of Gaines v. California Trust Company (1940), 15 Cal. 2d 255, 264-265:

> "The parol evidence rule, as is now universally recognized, is not a rule of evidence but is one of substantive law. * * * The rule as applied to contracts is simply that as a matter of substantive law, a certain act, the act of embodying the complete terms of an agreement in writing (the 'integration'), becomes the contract of the parties. The point then is not how the agreement is to be proved, because as a matter of law the writing is the agreement. Extrinsic evidence is excluded because it cannot serve to prove what the agreement was, this being determined as a matter of law to be the writing itself. The rule comes into operation when there is a single and final memorial of the understanding of the parties. When that takes place, prior and contemporaneous negotiations, oral or written, are excluded; or, as it is sometimes said, the written memorial supersedes these prior contemporaneous negotiations." (Emphasis Supplied by the Court).

It is submitted that the Tax Court's holding that the sale was complete on October 30, 1956, is erroneous for the reason that it is not supported by the facts found by the Tax Court or the evidence

from which those findings were made.

In the first place the Tax Court has fully set forth the written Memorandum Agreement of October 30, 1956, in its findings of fact. That Agreement clearly provided that Peterson was to operate Clock Restaurants as the agent of Smith, the seller. The Tax Court could not find otherwise when the Agreement was in evidence. The Agreement was drawn and to be performed in California. The rights of the parties thereunder are to be determined by the laws of California. Helvering v. Stuart (1942), 63 S. Ct. 140, 144, 29 AFTR 1209, 1213; Goold v. Commissioner (1950), CA-9, 182 F. 2d 573, 575, 39 AFTR 561, 563, reversing T. C. Under those laws "a contract in writing may be altered by a contract in writing, or by an executed oral agreement, and not otherwise". §1698, California Civil Code. "When the terms of an agreement have been reduced to writing by the parties, it is to be considered as containing all those terms * * * ." §1856, California Code of Civil Procedure. "The language of a contract is to govern its interpretation, if the language is clear and explicit, and does not involve an absurdity." §1638, California Civil Code. It was conceded by respondent's counsel at the trial and not otherwise found by the Tax Court that the language of the memorandum agreement of October 30, 1956, was clear (R. 389, 399). "When a contract is reduced to writing, the intention of the parties is to be ascertained from the writing alone, if possible; * * *." Paragraph (9) of the Memorandum Agreement of October 30, 1956, made it possible to ascertain that it was the intention of the parties that

Peterson was to operate Clock Restaurants as the agent of Smith, not as the owner thereof until the closing of a contemplated bulk sales escrow. Oral evidence may not be admitted to vary or contradict a plain provision of the Memorandum Agreement of October 30, 1956, that Peterson was the agent of Smith, not the owner of Clock Restaurants, until the closing of a contemplated bulk sales escrow. Keeler v. Murphy (1931), 117 Cal.App. 386.

There is no evidence in the record nor any finding by the Tax Court that the clear terms of the Memorandum Agreement of October 30, 1956, were at any time altered by a contract in writing. There is some evidence from which an inference could be drawn that the provisions of Section (9) of that Agreement were altered by an executed oral agreement in the year 1957. The facts found by the Tax Court will support such an inference but will not, in view of the statutory law of California with respect to the interpretation of written agreements, support one that Peterson was the owner rather than Smith's agent in the operation of Clock Restaurants at any time during the calendar year 1956. The plain terms of the written contract declare him to have been an agent. The following are facts indicating that his agency may have ripened into an ownership no earlier than the year 1957 through an executed oral contract which altered the provisions of Section (9) of the Agreement of October 30, 1956.

In each of twenty-three separate letters, each addressed to a different creditor of Clock Restaurants and dated either November 29 or 30, 1956 (a month after the Memorandum Agreement of

October 30, 1956), Robert O. Peterson stated. "As I have previously indicated to you, I intend to purchase certain of the Clock Restaurants from Forest G. Smith, Jr., and to assume certain of his liabilities. An escrow to complete the sale will be opened in the near future and notice of sale will be recorded and published." (R. 42, 285-307). That statement is consistent with the clear provision of Section (9) of the Agreement that Peterson was the agent of Smith rather than owner of Clock Restaurants on November 30, 1956.

On February 7, 1957, a notice of the intended sale of Clock Restaurants to B. D. S. Company and Peterson was filed in the Office of the County Recorder of Los Angeles and Orange Counties, California and published in a legal newspaper during the month of February, 1957, by Peterson (R. 44, 45, 412, 413). This notice recited in part:

> "That Forest G. Smith, Jr., vendor, whose address is 14000 East Telegraph Road in the City of Whittier, County of Los Angeles, State of California, intends to sell to B. D. S. Company, a limited partnership, and Robert O. Peterson, vendees, * * * . All stock in trade, fixtures, equipment of a certain restaurant business known as Clock No. * * * and that a sale, transfer and assignment of the same will be made, and the consideration therefor will be paid at 10:00 A. M., on the 25th day of February, 1957, at the office of Trippet, Yoakum, Stearns &

Ballantyne * * * " (R. 412).

The notice of sale was signed by B. D. S. Company, by Robert O. Peterson, General Partner and Robert O. Peterson. This notice of sale is consistent with the clear provisions of Section (9) of the Memorandum Agreement of October 30, 1956, to the effect that Peterson was the agent of Smith rather than the owner of Clock Restaurants as late as February 7, 1957.

On February 27, 1957, B. D. S. Company, by Robert O. Peterson, a general partner therein, addressed twenty letters, each to a different creditor of Clock Restaurants, and in each letter the following statement was made:

> " * * * The B. D. S. Company, a limited partnership, now doing business as Clock Restaurants, of which the undersigned Robert O. Peterson is a general partner, has completed purchase of Clock Restaurants from Forest G. Smith, Jr. In accordance with said letter to you of November 30, 1956, above referred to, the undersigned does hereby assume the liabilities of Forest G. Smith, Jr., mentioned in said letter, and does hereby guarantee payment of the unpaid balance thereof in consideration of your agreement not to demand payment so long as payments on account of said balance are made in the manner and at the rate set forth in said letter. * * * " (R. 311-349).

This statement in the letters to creditors is consistent with

the clear provision of Section (9) of the Memorandum Agreement of October 30, 1956, that Peterson was the agent of Smith rather than the owner of Clock Restaurants. It also supports the inference that the sale of Clock Restaurants was made by Smith on February 25, 1957, and that on that date Peterson's agency ripened into ownership when the statements in the notice of sale of February 7, 1957 are also considered.

Robert O. Peterson, one of the parties to the Agreement of October 30, 1956, testified that a bulk sales escrow was never opened because it was the opinion of himself, his partners and their counsel that there was no need for one (R. 395). Robert B. Ballantyne, counsel for Peterson and his partners in the transaction and a witness called on behalf of the respondent testified that no bulk sales escrow was ever opened for the reason that after Peterson had been in possession of the restaurants and had operated them for several months it was felt that an escrow was of no importance and not necessary (R. 406). The witness, Ballantyne, further testified that he attended to the matter of having a notice of sale published in February, 1957, for the purpose of finding out if there were any creditors or others that he and his client did not know about. A few claims were uncovered as a result of the publication (R. 407). This testimony is all compatible with the clear terms of Section (9) of the Memorandum Agreement of October 30, 1956, that until a bulk sales escrow was opened and closed Peterson operated Clock Restaurants as the agent of Smith and not as their owner. Until the contemplated escrow was closed the

Memorandum Agreement was an executory sales contract. There is not a scintilla of evidence that the terms of the written Memorandum Agreement were ever altered by a contract in writing. The evidence might support an inference that the provisions of Section (9) were altered by an executed oral agreement between the parties on or about February 25, 1957, and that on that date the sale of Clock Restaurants was consummated and Peterson was metamorphosed from operator as the agent of Smith to owner of the restaurants without the formality of a bulk sales escrow called for in the Agreement of October 30, 1956. It would follow however that there was no sale of Clock Restaurants to Peterson by Smith during the calendar year 1956.

It is submitted that the Tax Court erred in holding that the sale of Clock Restaurants by Forest G. Smith, Jr., to Robert O. Peterson was a closed and completed transaction in the calendar year 1956.

II

ROBERT O. PETERSON MERELY AGREED TO PURCHASE THE ASSETS OF CLOCK RESTAURANTS SUBJECT TO THE DEBTS OF FOREST G. SMITH, JR.

If the Tax Court was wrong in its conclusion that the sale of Clock Restaurants took place in 1956, it makes no difference in the present case whether Peterson assumed Smith's debts or merely took the assets of Clock Restaurants subject to those debts. It has

been stipulated by the parties and found by the Tax Court that Peterson did pay $326,443.08 of the debts during 1956 and $220,271.34 in 1957. The controversy concerns the question of whether the payment of $220,271.34 of Smith's debts by Peterson in 1957 was a gain realized by petitioners in that year as reported on their income tax return for that year or a gain realized in 1956 as determined by the Commissioner and the Tax Court. The Tax Court's decision on this point rests primarily upon its finding as a fact that as part of the consideration for Smith's sale of the restaurants to Peterson, Peterson assumed Smith's liabilities in the calendar year 1956 (R. 424).

The secondary question of whether the assumption, if it did occur, would of itself possess any fair market value is also present. It is, of course, elementary law that upon review a finding of fact of the Tax Court will be affirmed if the record contains any evidence to support the finding. Here the Tax Court had the Memorandum Agreement of October 30, 1956, respecting the sale of Clock Restaurants before it and fully set it forth in the findings of fact. That Agreement was clear (R. 420-423, 389, 399) and contained the following clause "Peterson hereby agrees to accept all of the above and foregoing assets referred to in paragraphs (1), (2) and (3) and to pay therefor by taking them subject to the liabilities as shown and disclosed on said financial statement dated September 30, 1956, * * * ". "The words 'subject to' normally connote in legal parlance an absence of personal obligation." Helvering v. Southwest Consolidated Corporation (1942),

62 S. Ct. 546, 551, 28 AFTR 573, 578; Andrews v. Robertson (1918), 177 Cal. 434, 439. The Agreement of October 30, 1956, is clear and upon the authorities set forth in the preceding pages of this brief the Tax Court was not at liberty to accept parol evidence to vary the terms of that Agreement. It could only be altered by a contract in writing or by an executed oral agreement. There is no evidence in the record that the agreement to pay for the assets by taking them subject to the liabilities was ever altered by an agreement in writing. The fact that Robert O. Peterson, the purchaser, did, on February 27, 1957, advise some twenty of Smith's creditors that he did, on that date and by a specific letter, thereby assume Smith's debts to them, might support a conclusion that on that date the written agreement to take "subject to " was altered by an executed oral agreement that Peterson would actually assume those debts. This did not occur before 1957 and that year was not involved in the Tax Court's decision here on review.

It is submitted that the record required a finding and conclusion that in the calendar year 1956 Robert O. Peterson merely agreed to purchase the assets of Clock Restaurants subject to the debts of Forest G. Smith but had assumed no personal liability for the payment of those debts prior to 1957.

III

THE AGREEMENT OF ROBERT O. PETERSON TO TAKE THE ASSETS OF CLOCK RESTAURANTS, SUBJECT TO THE DEBTS OF FOREST G. SMITH, JR., DID NOT CONSTITUTE THE RECEIPT OF MONEY BUT OF PROPERTY OTHER THAN MONEY -- WHICH WAS POSSESSED OF NO FAIR MARKET VALUE -- UNDER THE PROVISIONS OF SECTION 1001(b) OF THE INTERNAL REVENUE CODE OF 1954, UNTIL SUCH TIME AS THE DEBTS OF SMITH WERE ACTUALLY PAID BY PETERSON.

Section 1001(b) of the Internal Revenue Code of 1954 provides that "the amount realized from the sale or other disposition of property shall be the sum of any money received plus the fair market value of the property (other than money) received". The Senate Report dealing with the enactment of Section 1001(b) of the Internal Revenue Code of 1954 was as follows:

> "(1) The general rule in subsection (b) that the amount realized from the sale or other disposition of property is the sum of money received plus the fair market value of property received is qualified by the addition of special rules relating to real property taxes subject to the special treatment under section 164(d)." Page 5056 of 1954 U.S. Code, Congessional and Administrative News.

The provisions of §1001(b) of the Internal Revenue Code of 1954 were first enacted by Congress as a part of §202 of the Revenue Act of February 24, 1919, and were subsequently re-enacted

ten times without substantial change. Section 202, Revenue Acts of 1921, 1924 and 1926, Section 111, Revenue Acts of 1928, 1932, 1934, 1936, 1938, Section 111 of the Internal Revenue Code of 1939 and finally as Section 1001(b), Internal Revenue Code of 1954. The Senate Committee said of the provisions of §202(B) of the Revenue Act of 1918 concerning the basis for determining gain or loss:

> "A provision was inserted designed to establish the rule for determining capital gains in the case of exchange of property and to negative the assertion of tax in the case of certain purely paper transactions. The substance of the provision is that when property is exchanged for other property the property received shall be treated as the equivalent of cash to the amount of its fair market value * * * ." (Emphasis supplied).
>
> C. B. 1939-1 (Part 2), page 120.

The House Ways and Means Committee said while considering the Revenue Act of 1921:

> "The bill (subdivision [d]) provides new and explicit rules for determining gain or loss where property is exchanged for other property. Under existing law, 'when property is exchanged for other property, the property received in exchange shall for the purpose of determining gain or loss be treated as the equivalent of cash to the amount of its fair market value, if any * * * .' Probably no part of the present income tax

law has been productive of so much uncertainty and litigation or has more seriously interfered with those business readjustments which are peculiarly necessary under existing conditions. Under existing law the presumption is in favor of taxation. The proposed bill modifies that presumption by providing that on an exchange of property for property no gain or loss shall be recognized unless the property received in exchange has a definite and readily realizable market value; and specifies in addition certain classes of exchanges on which no gain or loss is recognized even if the property received in exchange has a readily realizable market value.

"The preceding amendments, if adopted, will, by removing a source of grave uncertainty, not only permit business to go forward with the readjustments required by existing conditions but will also considerably increase the revenue by preventing taxpayers from taking colorable losses in wash sales and other fictitious exchanges. Proper safeguards are found in subdivisions (e) and (f), which provide that where property is exchanged for other property and no gain or loss is recognized, the property received shall be treated as taking the place of the property exchanged, for the purpose of determining gain or loss and for the purpose of determining certain important deductions,

such as those for depreciation."

C. B. 1939-1 (Part 2), pages 175, 176.

The Senate Finance Committee said of the provisions of the Revenue Act of 1921:

"Section 202 (subdivision [c]) provides new rules for those exchanges or 'trades' in which, although a technical 'gain' may be realized under the present law, the taxpayer actually realizes no cash profit.

"Under existing law 'when property is exchanged for other property, the property received in exchange shall, for the purpose of determining gain or loss, be treated as the equivalent of cash to the amount of its fair market value, if any * * * .' Probably no part of the present income tax law has been productive of so much uncertainty or has more seriously interfered with necessary business readjustments. The existing law makes a presumption in favor of taxation. The proposed Act modifies that presumption by providing that in the case of an exchange of property for property no gain or loss shall be recognized unless the property received in exchange has a readily realizable market value, and specifies in addition certain classes of exchanges on which no gain or loss is recognized even if the property received in exchange has a readily realizable market value." C. B. 1939-1 (Part 2), page 188.

The wording of §202(c) of the Revenue Act of 1924 is identical with that of the first sentence of §1001(b) of the Internal Revenue Code of 1954. The House Ways and Means Committee said of that section of the 1924 Act:

> "Subdivision (c) does not correspond to any provision of the existing law but embodies in the law what is the correct construction of the existing law; that is that where income is realized in the form of property, the measure of the income is the fair market value of the property at the date of its receipt." (Emphasis supplied).
>
> C. B. 1939-1 (Part 2), page 250.

The Senate Finance Committee said of §202(c) of the Revenue Act of 1924:

> "Subdivision (c) does not correspond to any provision of the existing law but embodies in the law what is and always has been the construction of the law adopted by the Department and by the Courts; that is, that where income is realized in the form of property the measure of the income is the fair market value of the property at the date of its receipt." (Emphasis supplied).
>
> C. B. 1939-1 (Part 2), page 275.

The Tax Court concluded that:

> "Viewing the transfer of petitioners' property subject to his debts as the substantial receipt of money in the amount of such debts within the meaning of Section 1001(b)

of the 1954 Code, we do not find it necessary to decide whether or not the sale contract itself possessed a fair market value."

This conclusion ignores the intent of Congress when it enacted §1001(b) of the Internal Revenue Code of 1954 as well as the similar provisions found in the 1939 Code and eight revenue acts that preceded that Code.

What does "money" mean? The words of statutes -- including revenue acts -- should be interpreted where possible in their ordinary, every day senses. Crane v. Commissioner (1947), 67 S. Ct. 1047, 1051, 331 U.S. 1, 35 AFTR 776, 780; Old Colony R. Co. v. Commissioner (1952), 52 S. Ct. 211, 213, 10 AFTR 786, 788. The Court of Appeals is in a position to, as a matter of judicial notice, say that "money" is a word in common every day use and that an agreement to take assets subject to liabilities is not in the ordinary every day sense "money".

Bouvier's Law Dictionary (Baldwin's 1928 Edition), page 814, defines money to be "gold and silver coins. The common medium of exchange in a civilized nation". The Supreme Court of the United States said: "The word 'money' is often and properly used as applicable to media of exchange other than coin; banknotes, for example, lawfully issued and actually current at par in lieu of coin are treated as money because flowing as such through the channels of trade and commerce unquestioned." Woodruff v. Mississippi, 162 U.S. 291, 16 S. Ct. 820. The Supreme Court of California defined "money" to be "the general medium of exchange

referred to in order to designate the value of a thing". Link v. Faulkner (1864), 25 Cal. 404. The Circuit Court of Appeals for the Ninth Circuit held that "property includes money" in the case of Halliburton v. Commissioner (1935), 78 F. 2d 265, 16 AFTR 368, reversing B. T. A. But the same Court said in the later case of Pillar Rock Packing Co. v. Commissioner (1937), 90 F. 2d 949, 950: "There is no basis for considering accounts receivable as 'money'. They are properties. Insofar as the case cited is to the contrary we decline to follow it." In defining the "assets" of life insurance companies the Commissioner of Internal Revenue has defined the word "money", as used in §805(4) of the Internal Revenue Code of 1954, "to include cash, currency, bank deposits (including time deposits) whether or not interest bearing, share accounts in savings and loan associations, checks (whether or not certified), drafts, money orders and any other items of a similar nature." Reg. 1.805-5(a)(4). Webster's New Collegiate Dictionary defines money to be: "1. Metal, as gold, silver, or copper, coined or stamped, and issued as a medium of exchange * * * 4. Any form or denomination of coin or paper lawfully current as money; * * * 5. Anything customarily used as a medium of exchange and measure of value, as sheep, wampum, gold dust, etc. 6. Written or stamped promises or certificates, which pass current as a means of payment; paper money." It is submitted that the rights of Forest G. Smith, Jr., under the Memorandum Agreement of October 30, 1956, do not fit any known definition of the word "money" much less the ordinary, every day sense of the word which

the Supreme Court says must be used in construing revenue acts, Crane v. Commissioner, supra. Neither does it meet the definition of "cash equivalent" which was the terms used by the Tax Court. "Cash" is defined to be: "1. Money that a person actually has, including money on deposit; especially, ready money. 2. Bills, coins; currency. 3. Money, a check, etc., paid at the time of purchase: as, he paid cash for the house." "Equivalent" means "equal in value". Webster's New World Dictionary. Section 1001(b) of the Internal Revenue Code of 1954 and Treasury Regulation 1.001 - (a) both specifically provide that the amount realized from the sale of property "shall be the sum of any money received plus the fair market value of the property other than money received". They do not permit resort to a "cash equivalent by the Tax Court as a substitute for fair market value". The wording of the statute is clear and leaves no room for interpretation.

Forest G. Smith, Jr., received the promise of Robert O. Peterson, to take the assets of Clock Restaurants subject to the debts of Smith and that is all he ever received until such times as Smith paid those debts and Smith's creditors had cancelled his obligations. Even then Peterson could return the assets and require Smith to repay any moneys advanced to the latter's creditors. This arrangement placed no cash or its equivalent in Smith's hands. Until the debts had been paid, Smith was fully obligated to pay them. He was not until then released from those debts. He was not until then discharged from those debts. He had not until then

in any sense received money in any form, directly or indirectly, from the sale of Clock Restaurants. He had not until then received any property other than money that he could hope to find a buyer for under any circumstances. To ask the question, "what fully informed buyer could be found who would pay anything for Peterson's agreement to take the assets of Clock Restaurants subject to Smith's debts?" is to answer it. The Tax Court sought to avoid finding an answer to this question by saying that the promise was the equivalent of cash. That procedure simply ignores all the known definitions of the words "money" and "cash". It also ignores the applicable provisions of the Internal Revenue Code.

The testimony of Harold B. Lloyd, a witness called by the taxpayers, an appraiser with thirty years of experience and twenty-five years of service with the Internal Revenue Department as an appraiser and liquidator of assets which were subject to government liens, testified that in his opinion the rights of Forest G. Smith under the Agreement of October 30, 1956, Exhibit 6-F, had no fair market value at any time during the calendar year 1956 (R. 377, 370). His reason for the conclusion that Smith's rights had no fair market value was that he could conceive of no prudent and well adjusted individual paying money for such a contract. It had no discernible market (R. 378). The record contains no testimony or other evidence that Smith's rights under the Contract of October 30, 1956, did have any fair market value. It is submitted that the Tax Court was not relieved of the duty imposed by §1001(b) of the Internal Revenue Code of 1954 to find the fair market

value, or lack thereof, of Smith's rights under the Contract of October 30, 1956, without specifically finding that he did receive money in the amount of $603,687.96 in 1956 under that Contract. The Tax Court was only permitted by that section of the Internal Revenue Code to determine that Smith received money or that he had received the "equivalent of cash" to the amount of the fair market value of property other than money received. It could resort to the "cash equivalent only in case no money was received and then it first had to determine what the fair market value of the property received was in order to arrive at the measure of the equivalent". The evidence in the record is that no money was received beyond the payments of $326,443.08 made on Smith's debts in 1956 by Peterson and the "equivalent" to be related to cash was nil because there was no market for the equivalent; it had no fair market value.

No argument is advanced by the taxpayers that any of the gain realized from the sale of Clock Restaurants by Forest G. Smith was exempt from taxation. Their contention is that the gain was realized only when Peterson had paid Smith's creditors and released Smith from any and all obligation to reimburse Peterson for the payments made to those creditors. Douglas v. Willicuts (1935), 296 U.S. 1, 56 S.Ct. 59, 16 AFTR 970; Old Colony Trust Co. v. Commissioner (1929), 49 S.Ct. 499, 7 AFTR 8875; U.S. v. Boston & M. R.R. (1929), 49 S.Ct. 505, 7 AFTR 8881. The controlling principle is that income applied on a debt is constructively received. Sowell v. Commissioner (1962), CA-5, 302 F.2d 177,

9 AFTR 2d 1347. Until payment, Smith's obligation had not been reduced. Until then he was obligated to Peterson in the same amount that he owed the creditors whose claims had been satisfied. Until then he had realized no gain on the sale of Clock Restaurants within the intent of §1001(b) of the Internal Revenue Code of 1954. Until then he had merely traded creditors as that term was expressed in the case, Commissioner of Internal Revenue v. North Shore Bus Co., Inc. (1944), CCA-2, 143 F. 2d 114, 32 AFTR 931; not until then were the fruits of Forest G. Smith's gain on the sale of Clock Restaurants available for the payment of the income tax on that gain. At that time the gain was taxable. See Easson v. Commissioner (1960), 33 T. C. 963, 970, footnote 8, reversed CA-9, 249 F. 2d 653, 8 AFTR 2d 5448, wherein this Circuit Court said: " * * * Section 112(k) provides, clearly, that an assumption of liability is not the payment of 'other property or money', and to hold that such assumption constitutes a cash payment is a clear contradiction of the words of the statute. * * * It is our belief that the purpose of the tax laws will best be served by not assessing a tax against a taxpayer until he realized his gain in a transaction in which, realistically speaking, he actually changes his position. * * * " Forest G. Smith, Jr. 's position with respect to his creditors changed only when those creditors were paid. Until then none of them released him from his personal obligation to pay his debts.

The Sixteenth Amendment authorizes the taxing of income but not the taxing of the intangible and non-negotiable contingencies

of a taxpayer on the cash receipt basis, that may in a later year result in income. D. D. Oil Company v. Commissioner (1945), CCA-5, 117 F.2d 936, 33 AFTR 755. That aptly describes the rights Forest G. Smith, Jr., had under his contract for the sale of Clock Restaurants during the calendar year 1956. Those rights of Smith were intangible and non-negotiable contingencies.

Nor do those rights fit any definition of "money" that can even be inferred from the opinion of the Supreme Court in the case of Crane v. Commissioner, 331 U.S. 1. The Tax Court does not quote the Supreme Court in the Crane case when it says in its conclusions of law: "The agreement of one to discharge the personal obligation of a taxpayer for a valid consideration is tantamount to the receipt of cash by the taxpayer in the amount of such obligation and this is so even though the discharge of the obligation is effected only by the transfer of the taxpayer's property subject to his debts. Crane v. Commissioner, 331 U.S. 1." What the Supreme Court actually said on that question goes more to support the contention advanced by the petitioners in this review than the conclusion reached by the Tax Court. The Court of Appeals for the Third Circuit observed, accurately, in the case of Simon v. Commissioner (1960), 6 AFTR 2d 6077, 6080, 285 F.2d 422, affirming 32 T.C. 935, "The Court in Crane was faced solely with the question of determining the adjusted basis of real estate." There is no dispute in the pending case concerning the adjusted basis of Clock Restaurants. That has been stipulated to be $290,134.40 and so found by the Tax Court. The Supreme Court

said in the course of its opinion in the Crane case that it was not "strictly speaking" concerned with the question of whether the vendor was in receipt of money or property but that the crux of the case really was whether the law permitted her to exclude allowable deductions (for depreciation on an apartment building) from consideration in computing gain (67 S. Ct. 1055, 35 AFTR 784). This is very different from holding that the vendor of Clock Restaurants was in receipt of money in a sum equal to the debts of that business, which were precisely equal to the value of the assets, when the purchaser agreed to take the assets subject to the liabilities. The taxpayer in the Crane case was at no time personally liable for any part of the mortgage debt in question. Here the taxpayers, and they alone, were liable for the debts of Smith until Peterson agreed with the creditors on February 27, 1957, to assume and pay those debts.

The Supreme Court said in the Crane case (67 S. Ct. 1054, 1055, 35 AFTR 783, 784): " * * * As for the second, we think that a mortgagor, not personally liable on the debt, who sells the property subject to the mortgage and for additional consideration, realizes a benefit in the amount of the mortgage as well as the boot. * * * 37/." (Emphasis supplied). The appended footnote reads: "Obviously, if the value of the property is less than the amount of the mortgage, a mortgagor who is not personally liable cannot realize a benefit equal to the mortgage. Consequently a different problem might be encountered where a mortgagor abandoned the property or transferred it subject to the mortgage

without receiving boot. That is not this case." The record is clear that Forest G. Smith, Jr. received no boot in the transaction with Robert O. Peterson. As of the end of 1956 Smith, and he alone, was still liable for such of his debts as had not been paid. Where did he benefit in any amount above the debts actually paid?

The "boot" was paid in cash to the vendor in the Crane case. Neither Forest G. Smith, Jr. nor any assignee of his, could ever get any cash -- Smith's creditors or their assignees might get cash if Peterson chose to pay them rather than to exercise his option to return Clock Restaurants to Smith and demand repayment of any sums advanced to creditors of the business in 1956. The Crane case gives no support to the Tax Court's conclusion that Smith was in the receipt of an equivalent of cash at any time before the debts of Smith were actually paid by Peterson.

The Supreme Court decided the Crane case in 1947. Congress and its committees had, for nearly thirty years previous to that time, been saying in successive revenue acts and in §111(b) of the Internal Revenue Code of 1939 that the amount realized from the sale of property shall be the sum of money received plus the fair market value of the property (other than money) received. Congress enacted §1001(b) of the Internal Revenue Code of 1954 which provides "the amount realized from the sale or other disposition of property shall be the sum of any money received plus the fair market value of the property (other than money) received". The Commissioner's own Regulation No. 1.1001-1(a) under the 1954 Code contains the same provisions.

It is submitted the decision of the Supreme Court in the Crane case was not concerned with the amount realized on the sale of property but with the basis for computation of gain and does not conflict in any way with the expressed intent of Congress.

It is further submitted that the Agreement of Robert O. Peterson to take the assets of Clock Restaurants subject to the debts of Forest G. Smith, Jr., did not constitute the receipt of money by Smith under the provisions of §1001(b) of the Internal Revenue Code of 1954, until such time as the debts of Smith were actually paid by Peterson.

IV.

THE TAX COURT ERRED IN DECIDING THAT THERE WERE DEFICIENCIES IN THE PETITIONERS' REPORTED INCOME TAXES FOR THE CALENDAR YEARS 1954, 1955 AND 1956 INSTEAD OF OVERPAYMENTS OF THOSE TAXES IN SAID YEARS.

If the foregoing contentions of the petitioners are sustained, it will follow, as a matter of computation, that there were overpayments rather than deficiencies in the years involved.

CONCLUSION

It is respectfully submitted that the decision of the Tax Court should be reversed and the matter remanded to it with directions to redetermine petitioners' Federal income taxes for the calendar years 1954, 1955 and 1956, respectively, in accordance with the opinion of the Court of Appeals for the Ninth Circuit.

Dated: May 28, 1963.

Respectfully submitted,

ERNEST R. MORTENSON

EUGENE HARPOLE

By /s/ Eugene Harpole
EUGENE HARPOLE

Attorneys for Petitioners and Appellants

APPENDIX "A"

EXHIBITS REQUIRED BY RULE 18(f)

Exhibits	Page of Record For Identification	Page of Record For Evidence
Joint Exhibits 1-A through 21-U	8	8
Petitioners' Exhibits 22 through 25	60	60

WITNESSES

	Direct	Cross
Harold B. Lloyd	16	19
Robert O. Peterson	32	48
Robert B. Ballantyne	53	56